

other non-price benefits to the MDU, such as implementation of a property information channel,⁵⁵ which the owner will then use to enhance other aspects of the MDU to benefit his or her tenants.

By contrast, without an exclusive contract and the various efficiencies it affords, the MVPD would not be able to offer, and the MDU owner would not be able to demand, such discounted bulk pricing or other non-price benefits. In fact, the MVPD may even find it unprofitable to serve the MDU at all.

Given the intense level of competition MDU owners face to attract tenants, the foregoing benefits that the MDU owner is able to extract from an MVPD in exchange for the granting of exclusive access to the MDU will be passed on to the tenants in that MDU. An MDU owner will only enter into an exclusive contract with an MVPD if the benefits, in terms of making the MDU more attractive, outweigh the costs of not allowing each resident to choose his or her own service provider. The Commission itself, in the Inside Wiring Order, acknowledged this fact:

We continue to believe that, in rental MDUs, market forces will compel MDU owners in competitive real estate markets to take their tenants' desires into account. ... MDU owners must compete with rival owners to keep current residents and attract additional residents. In this context, an MDU owner that agrees to an exclusive contract in exchange for a monetary payment but does not somehow flow that payment through to its residents

⁵⁵ A property information channel is created through character generator equipment supplied by the MVPD, which allows the MDU owner to essentially produce and deliver to all MDU tenants a customized cable channel which carries programming about the MDU and the surrounding property. MDU owners may use this channel to provide information about events occurring on the property, as well as to sell advertising to local vendors.

(e.g., a new swimming pool, a security system, or discounting the rent below the competitive level) is vulnerable to competition from similarly situated MDUs offering a more attractive mix of price and amenities to prospective tenants. If the MDU owner tries to simply keep the payment, new tenants will not be as attracted to the building and existing tenants will have an additional reason to relocate to another MDU (e.g., an otherwise similar residence where, to attract tenants, the owner has utilized its exclusive access payment to reduce rent or improve amenities).⁵⁶

In short, since exclusive contracts often cause MVPDs to extend additional benefits to MDU owners, and since MDU owners will pass these benefits along to their tenants to remain competitive in the real estate market, any restrictions which the Commission were to impose on exclusive MDU contracts would simply reduce the potential benefits to MDU tenants. Seen in this light, the marketplace itself will be the best arbiter of the restrictions, if any, which apply to exclusive MDU contracts. In fact, the Commission only two months ago agreed with this conclusion in its Inside Wiring Order:

We believe that [MDU owners will pass on the benefits of MDU exclusive contracts to their tenants and therefore that] consumer welfare will be maximized by letting the market determine the appropriate mix of price and amenities in the MDU marketplace.⁵⁷

⁵⁶ Inside Wiring Order at ¶ 61 (emphasis added). See also id. at ¶ 42 ("We disagree that the building-by-building procedural mechanism does not benefit consumer choice because it merely substitutes one MVPD for another. ... Generally, MVPDs encounter an environment in which the MDU owner must compete with similarly-situated MDU owners to attract and retain tenants. ... MVPDs competing for the right to serve the building generally will have to offer the mix of video service quality, quantity and price that will best help the MDU owner compete in the marketplace.").

⁵⁷ Id. at ¶ 61.

The Commission cannot cite the fact that MDU exclusive contracts will result in benefits to MDU tenants as support for its new inside wiring rules without also acknowledging that these benefits undercut any rationale for restricting exclusive MDU contracts in this proceeding.

It is important to emphasize that the benefits which MDU exclusive contracts provide to MDU tenants are not limited to instances in which multiple MVPDs bid for an exclusive MDU contract. Even if an MDU owner is negotiating with only a single MVPD, it can still use the promise of exclusivity to that MVPD to extract lower prices, additional services, or other benefits and concessions from the MVPD. Indeed, TCI's exclusive MDU contracts entered into many years ago, at a time when the level of MVPD competition was not as vibrant as it is today, illustrate this point. These contracts typically contain benefits that are not included in TCI's MDU contracts entered into at the same time but which do not afford TCI exclusivity.⁵⁸

Finally, some of the cable industry's strongest competitors in the MDU marketplace have recognized the pro-competitive and pro-consumer benefits of exclusive MDU contracts. For example, OpTel has consistently opposed any efforts by the Commission to limit or

⁵⁸ Thus, TCI believes that the legal and policy analyses set forth in these comments apply equally to both existing and future exclusive MDU contracts and that the Commission should treat all exclusive MDU contracts the same in rejecting the proposals set forth in the Second FNPRM. See id. at ¶ 259.

prohibit the flexibility of MVPDs and MDU owners to enter into exclusive contracts:

Given the economics of the MDU marketplace, the ability of competing service providers and MDU owners to negotiate for exclusive right of entry agreements is essential to the development of competition in this market. Service providers need exclusivity to recover their investment in plant and equipment that is needed to serve an MDU and MDU owners need it to tailor the best package of video and telecommunications services for MDU residents.⁵⁹

The Independent Cable & Telecommunications Association echoed these sentiments, as well:

Competition in the MDU market will best be advanced if the MDU owner, through the exercise of its private property rights, is allowed to determine which provider(s) will service its property and is allowed to grant a chosen provider exclusive access⁶⁰

⁵⁹ Ex Parte Letter of OpTel, Inc. filed on June 25, 1997, in CS Docket No. 95-184, at 6 (emphasis added). See also Ex Parte Letter of OpTel, Inc., filed on November 20, 1996, in CS Docket No. 95-184, at 2 (same); Ex Parte Letter of OpTel, Inc. and MultiTechnology Services, L.P., filed on July 23, 1996, in CS Docket No. 95-184, at 2 ("The availability of exclusive rights-of-entry also allows MDU property owners and ownership associations to bargain with service providers for superior video and telecommunications services for MDU tenants and residents.") (emphasis added); Reply Comments of OpTel, Inc., filed on October 6, 1997, in CS Docket No. 95-184 and MM Docket No. 92-260, at 9 (same).

⁶⁰ Ex Parte Submission of Independent Cable & Telecommunications Association, filed on February 27, 1997, in CS Docket No. 95-184, at 1. See also Reply Comments of SBC Communications, Inc., filed on April 17, 1996, in CS Docket No. 95-184, at 6-7 ("The Commission should not dictate rules in [the area of exclusive contracts]. Whether or not to enter into an exclusive arrangement is a matter of private contract between the service provider and the property owner. The parties involved should be allowed the freedom to exercise their own choice in this area."); Ex Parte Letter of GTE, filed on March 18, 1997, in CS Docket No. 95-184, at 4 ("[E]xclusive contracts entered into between MDU building owners and new entrant MVPDs provide many benefits. ... The FCC should therefore refuse to break with its precedent that avoids

(continued ...)

The broad acceptance of the benefits of MDU exclusivity among MVPD competitors underscores the lack of any persuasive reason for the Commission to restrict such exclusivity.

IV. TCI'S SPECIFIC RESPONSES TO THE QUESTIONS AND PROPOSALS IN THE SECOND FURTHER NOTICE.

A. The Second FNPRM's "Cap" Approach to Restricting Exclusive MDU Contracts is Fundamentally Flawed Because it Incorrectly Focuses Solely on the Recovery of Capital Costs.

1. MDU Exclusive Contracts Provide Significant Benefits to MDU Tenants Beyond Cost Recovery.

While, as noted, the Second FNPRM acknowledges the benefits exclusive MDU contracts provide with respect to the MVPD's recovery of its capital costs, it apparently, and incorrectly, assumes that these benefits are the only basis for allowing MDU exclusivity. Thus, many of the Second FNPRM's questions and proposals are written in terms of the appropriate length of time necessary to allow such cost recovery to occur. However, by focusing solely on the cost recovery aspect of exclusive MDU contracts, the Second FNPRM completely ignores the other pro-competitive and pro-consumer benefits these contracts provide, as shown above. As a result, the Second FNPRM's "cap" approach is misguided and should be rejected.

(... continued)

interference with private contracts, particularly where there is no FCC authority to support such action."); Ex Parte Letter of GTE, filed on March 31, 1997 in CS Docket No. 95-184, at 21-23 (citing other contexts in which the Commission has repeatedly found that exclusive contracts benefit both carriers and customers).

As an initial matter, TCI notes that even where it has faced significant competition in a bid to serve an MDU, TCI has been able to secure exclusive contracts with terms ranging from five to 10 years. Thus, at the very least, the Second FNPRM's proposed seven-year cap is inconsistent with the realities of the current and highly competitive MDU marketplace.

More fundamentally, any cap on the term of an exclusive MDU contract will reduce consumer welfare. By imposing an arbitrary term limit on such contracts, the Commission would be forcing MDU residents to forego the benefits that would have been available had a longer exclusivity term been permissible and negotiated by the MVPD and the MDU owner. For example, if an MDU owner wants to extract from TCI an additional discount for its cable service in exchange for a 10-year exclusive contract, why should that MDU owner be limited by an artificial Commission rule which restricts the term of the exclusivity provision to seven years, or to any other pre-ordained term? In such a situation, the FCC rule could actually reduce the benefits or other amenities offered to MDU tenants, because TCI might be unwilling to provide the same level of benefits for a seven-year exclusivity that it would for a 10 year exclusivity.

**2. Limiting any MVPD to a Single Exclusivity Period
Would Reduce Competition and the Benefits to MDU
Tenants.**

For similar reasons, the Commission should reject the suggestion in the Second FNPRM that an MVPD should be limited to negotiating only a one-time exclusivity period with an MDU owner and thereafter be precluded from renewing the exclusive contract

unless the new contract is necessary to recover the costs for a substantial new investment in the MDU.⁶¹ Once again, by focusing solely on the cost recovery issue, the Second FNPRM ignores the fact that such a proposal would actually disadvantage consumers by removing a potential bidder from the MDU auction process. The following example may best serve to illustrate this problem:

EXAMPLE: Assume that there are two MVPDs serving a particular area in which an MDU is located. In year one, the two MVPDs bid for the right to serve the MDU exclusively. MVPD #1 wins a 10-year exclusive contract in return for the provision of service to the MDU at a significant discount from the MVPD's standard rates in the franchise area. In year 11, the MDU owner wants to have another auction for the building to award an exclusive contract. If the Commission were to limit an MVPD to a one-time exclusivity period with a particular MDU, MVPD #1 could not bid in year 11, and the MDU owner would be faced with a single bidder. While the MDU owner could still negotiate a favorable deal for its tenants in exchange for granting an exclusive contract to MVPD #2, MVPD #2 may not offer the level of benefits to the MDU that it might otherwise have offered if there was a possibility that MVPD #1 could win an exclusive contract to the building. As a result, the MDU tenants are denied such additional benefits that would have resulted from a fully competitive bidding process for the building. Moreover, at the end of the exclusive contract for MVPD #2, the Commission's rule would mean that neither MVPD #1 nor MVPD #2 could enter another exclusive contract with the MDU owner. The result would be that both providers would have significantly reduced incentives to extend the discounts or other benefits they previously extended to the MDU.

In addition, the rule would reduce the incentive of either provider to invest in significant upgrades to its plant or service offerings within the MDU toward the end of the contract because the

⁶¹ Second FNPRM at ¶ 260.

Commission's one-time exclusivity rule would create uncertainty as to whether the MVPD would be able to recover the costs of such upgrades.

In short, even if the Commission had the authority to restrict exclusive MDU contracts, the proposals under its cap approach should not be adopted because they are inconsistent with the realities of the marketplace.

3. MDU Owners Should Not Be Permitted to Terminate Exclusive Contracts and Retain the Inside Wiring in Exchange for a Payment of the MVPD's Unrecovered Investment Costs.

TCI strongly opposes the suggestion in the Second FNPRM that MDU owners would be permitted unilaterally to abrogate their existing exclusive contracts and to retain the inside wiring as long as they pay the MVPD for any unrecovered investment costs.⁶²

Just as the Communications Act precludes the Commission from itself abrogating existing contracts between MDU owners and MVPDs, it also prohibits the Commission from authorizing one of the parties to the agreement, over which it has absolutely no jurisdiction, to terminate a contract which that party entered into at arms length with the MVPD. The Commission may not achieve indirectly what it is prohibited from doing directly.⁶³

⁶² Id. at ¶ 260.

⁶³ Richmond Power & Light of the City of Richmond, Indiana v. FERC, 574 F.2d 610, 620 (D.C. Cir. 1978) ("What the Commission is prohibited from doing directly it may not achieve by indirection") (citations omitted). See also discussion at pp. 18-21, *supra*, regarding the lack of Commission authority to use a "fresh look" mechanism in the MDU context.

Beyond this fundamental jurisdictional limitation, this proposal is problematic for two additional reasons. First, there is no basis for the Commission to presume that existing exclusive contracts between MVPDs and MDU owners, no matter for how long, were anything but the product of arms-length negotiations. Indeed, in light of the discussion above regarding the benefits of exclusive MDU contracts and the highly competitive nature of the MDU real estate business, it is equally, if not more, likely that MDU owners sought out such exclusive contracts with MVPDs in order to extract certain concessions from the MVPD which could then be used to enhance the value of the MDU owner's property for its tenants. This reality is certainly consistent with TCI's experience.⁶⁴

Second, even if the Commission had the jurisdiction to authorize such MDU owner-initiated abrogation, the level of compensation suggested in the Second FNPRM would be woefully inadequate to make the incumbent whole.⁶⁵ Unlike in the Commission's Inside Wiring Order, in which the compensation issue was more limited since it only arose when the MVPD's underlying contract to serve the MDU had expired on its own terms, here the

⁶⁴ TCI also notes that it has consistently maintained throughout this proceeding that MDU owners act in the interest of their tenants. See, e.g., TCI's Comments on the Further Notice of Proposed Rulemaking in CS Docket No. 95-184; MM Docket No. 92-260, filed on September 25, 1997, at 8-9.

⁶⁵ See Second FNPRM at ¶ 260 (suggesting that the applicable compensation mechanism would simply be reimbursement of "unrecovered investment costs").

Commission would be prematurely terminating both the contract and the expected revenue stream of the incumbent. As a result, any payment scheme would have to incorporate a component to compensate the incumbent for such lost expected revenues.⁶⁶

B. The Second FNPRM's Alternative "Market Power" Approach to Restricting MDU Exclusive Contracts is Even More Problematic than the Cap Approach.

As an alternative to the cap approach, the Second FNPRM asks whether it should prohibit MVPDs with "market power" from entering into or enforcing exclusive MDU contracts.⁶⁷ This proposal is even more problematic than the cap approach.

First, as the discussion in section II, supra, makes clear, the Commission is without authority to prohibit exclusive MDU contracts at all, let alone in a discriminatory manner on an isolated segment of the MVPD marketplace.⁶⁸

⁶⁶ Cf. NL Industries, Inc. v. U.S., 1987 U.S. Cl. Ct. LEXIS 91, **42 (U.S. Claims Ct. 1987) (concluding that just compensation in a case where the government takes a contract would include calculation of anticipated lost profits or revenues); Long Island Water Supply Co. v. Brooklyn, 166 U.S. 685 (1897) (recognizing that right of exclusivity is factor to be considered in determining just compensation which includes "the reasonably just expectations which those who have invested money in its work had in mind when so investing"); Monongahela Navigation Co. v. U.S., 148 U.S. 312, 326-27 (1893) (valuation of property for determining just compensation included the profits of the property, namely the tolls that would have been collected by the lock and dam taken by the government).

⁶⁷ Second FNPRM at ¶¶ 261-262.

⁶⁸ Also as noted, any discriminatory handicaps which the Commission were now to impose on cable operators' ability to enter into or to enforce exclusive MDU contracts because of some hypothesized notion of market power would be squarely at odds with Congress' action in the 1996 Act to remove such regulatory handicaps from cable operators in the MDU marketplace.

Second, while one might argue that an assessment of an MVPD's "market power" (such as whether the MVPD is subject to "effective competition") is appropriate in connection with an analysis of an MVPD's rates to end users across a franchise area, it is unwarranted in the context of the MDU marketplace. As noted earlier, MDUs are unique footholds of competition. These buildings are highly targeted by cable competitors, such as SMATV, MMDS, and DBS operators, so the fact that a cable operator is the prevalent player in a particular franchise area says nothing about whether it has market power in the MDU marketplace. In fact, in many instances, TCI has been at a disadvantage in the MDU context when competing against non-cable MVPDs, because, unlike TCI, such operators are permitted to (and often do) focus their time, energy, and funds on individual properties and also are free of the regulatory constraints under which TCI must operate.⁶⁹

Third, the Commission does not articulate any principled basis for identifying or presuming that any particular exclusive contract is the product of "market power," as opposed to legitimate business objectives and arms-length bargaining. Indeed, as shown above, and as acknowledged by the Commission in the Inside Wiring Order, MDU owners enter into exclusive contracts to extract additional benefits from the MVPD that will make their buildings more

⁶⁹ It is thus not surprising that non-cable operators, such as Optel, ICTA (the SMATV trade association), GTE, and SBC, among others, strongly support exclusive MDU contracts. See discussion at pp. 25-27, supra.

attractive to tenants in the highly competitive MDU real estate marketplace. The mere fact that certain MDU owners may now wish to abrogate existing exclusive contracts because they believe doing so would allow them to negotiate an even better deal today does not mean that their existing agreements were somehow foisted upon them as a result of the MVPD's market power. If cable operators had the power to effectively impose such "adhesion" contracts, most, if not all, MDU contracts that TCI and other cable operators entered 15 or more years ago would have contained an exclusivity provision. This is not the case. In fact, many of TCI's MDU contracts that were signed 15 or more years ago never contained an exclusivity provision.⁷⁰ The fact that in many cases in the past MDU owners, for whatever reason, elected not to extend exclusivity to TCI reinforces that those MDU owners which did extend exclusivity did so not because they felt compelled as a result of any perceived market power, but because it was in their, and their tenants', interests to do so.

Finally, such an exclusionary "market power" rule would actually diminish competition and consumer welfare. By removing potential bidders from the auction for an MDU service contract, it

⁷⁰ Approximately 30-40% of the MDU contracts that TCI has entered since 1994 contain an exclusivity provision, with terms ranging from 5 to 10 years, in exchange for a bulk discount and/or other significant benefits to the MDU.

would reduce the benefits the MDU owner could extract from the remaining MVPDs and pass along to its tenants.⁷¹

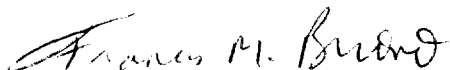
Because the Second FNPRM's suggested market power approach is at odds with both marketplace realities and congressional directives, it should also be rejected by the Commission.

V. CONCLUSION

For the foregoing reasons, TCI respectfully urges the Commission to refrain from implementing the proposals in the Second FNPRM or any restrictions on exclusive MDU contracts.

Respectfully submitted,

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⁷¹ See also the example set out at p. 29, supra, in connection with the Second FNPRM's proposal to limit MVPD's to a single exclusivity period.